

LRC Committee on Property Insurance Rate Making

MINUTES

December 1, 2011

Opening Remarks

The LRC Committee on Property Insurance Rate Making was called to order by Senator Harry Brown at 1:03 PM in Room 1027 of the Legislative Building. There were seven members present including Senator Harry Brown (chair), Senator Ralph Hise, Senator Stan White, Representative Frank Iler, Representative Jonathan Jordan, Representative Pat McElraft and Representative Michael Wray. Research Division Staff members present were Kory Goldsmith, Tim Hovis and Amy Jo Johnson. Jeff Cherry of the Bill Drafting Division was also present. Committee assistants Darryl Black, Beth LeGrande and Elise Quick were also present.

Senator Brown started the meeting by recognizing the Sergeant at Arms and Staff present at the meeting.

Modeling and Factors Associated with Rate-Making Territories

Senator Brown introduced Mr. Ray Evans, General Manager of the North Carolina Rate Bureau.

North Carolina Rate Bureau

Mr. Ray Evans introduced himself as the General Manager of the North Carolina Rate Bureau and explained the Rate Bureau will continue their presentation from the November 2, 2011 meeting. He stated Ms. Shantelle Thomas, Chair, Property Insurance Committee, and Ms. Sue Taylor, Director of Insurance Operations, will also present information to the committee on behalf of the Rate Bureau.

Mr. Evans explained the purpose of the Rate Bureau's presentation is to inform, educate and provide the committee with data from the Rate Bureau. He reminded the committee the Rate Bureau does not lobby or advocate for any position. He stated the Rate Bureau asserts the need for fair and adequate rates.

Mr. Evans then introduced Ms. Sue Taylor, Director of Insurance Operations at the Rate Bureau. He mentioned Ms. Taylor is responsible for overseeing ratemaking and rulemaking for worker's compensation insurance, private passenger automobile insurance and personal property insurance. He stated she will answer questions the Rate Bureau was unable to answer at the last meeting.

He then provided a brief outline of the Rate Bureau's presentation to the committee. He stated the presentation will include discussion of the ratemaking process, catastrophe modeling and House Bill 1305 (specifically, how territories are determined, aspects of hurricane mitigation credits).

He then thanked Senator Brown and the committee for allowing the Rate Bureau to speak at the meeting and re-introduced Ms. Sue Taylor as the Bureau's first speaker.

Ms. Taylor stated she intended to answer questions the committee had from the November 2 meeting and provide more information on the residential property insurance market.

She mentioned there are three types of residential property insurance policies in North Carolina: homeowners, dwelling fire and mobile home. She said there are approximately three million residential property insurance policies in the state.

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She then referred to a question posed in the last meeting regarding deductibles, specifically percentage deductibles. She stated the Rate Bureau understands that the public may not understand deductibles and how they apply at the time of a loss.

Ms. Taylor referred to the deductible data provided in the Rate Bureau's presentation (see attachment 1) and the distribution of the deductibles for the voluntary market across the state. She emphasized the deductibles are strictly flat deductibles with no wind deductible. She said (based on the deductible data she presented) 90 percent of policyholders in the state have strictly a flat deductible and no wind deductible.

Ms. Taylor then discussed Rate Bureau membership. She provided an answer to a question asked in the last meeting regarding the actual number of companies writing residential property insurance in the state. She stated that of the 621 companies licensed to write residential property insurance, 97 write homeowners policies, 60 write dwelling policies and 15 write mobile home policies.

Ms. Taylor asked the committee if they had any questions based on the information she presented.

Senator Brown asked Ms. Taylor to discuss the 10 percent of policyholders who also have a wind deductible.

Ms. Taylor explained the answer to Senator Brown's question by using an example. She said that, of the 10 percent not mentioned in the Rate Bureau's data (see attachment 1), 6 percent of policyholders could have strictly flat deductibles less than \$250, 3 percent may have deductibles of \$100 and 1 percent of policyholders may have more than a \$2,500 deductible.

Ms. Taylor emphasized once the large deductibles and the miscellaneous deductibles that are not provided in the Rate Bureau's data are factored in (see attachment 1), only four percent of policies in the state have both a flat deductible and wind deductible in the voluntary market.

Senator Brown asked what types of deductibles are included in the four percent.

Ms. Taylor said the other deductibles are either wind deductibles (ranging from 1 to 2 percent) or flat deductibles (ranging from \$50-\$2,500).

Senator Brown asked if two percent was the maximum deductible for wind policies. Ms. Taylor responded that five percent is the maximum deductible.

Senator Brown asked if the 97 companies writing homeowners insurance include all of the coastal counties. Ms. Taylor answered that the 97 companies do include all of the coastal counties.

Senator Brown recognized Senator Hise for a question.

Senator Hise referred to the 1 percent 'Named Storm surcharge' mentioned in the November 2 meeting. He asked if the 1 percent surcharge applies to someone who has a \$500 flat deductible policy. Senator Hise asked if it would then become a \$500 deductible plus 1 percent of the damage if there is a Named Storm. Ms. Taylor said this scenario is possible but the numbers provided were strictly for policies with a \$500 deductible that did not have the 1 percent Named Storm surcharge applied.

Senator Brown referred back to his earlier question regarding the five percent maximum deductible for wind policies. He asked Ms. Taylor to explain how the deductible percentage is determined.

Ms. Taylor said the deductible is determined by the agent's suggestions to the policyholder, but the deductible percentage is ultimately determined by the policyholder.

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Senator Brown asked for further questions. There were no other questions for Ms. Taylor and Mr. Ray Evans began a discussion of the ratemaking process.

Mr. Evans reminded the committee of the steps associated with the ratemaking process (see attachment 1).

Mr. Evans explained the ratemaking formula and stated that the ultimate product of insurance is the payment of a claim sometime in the future.

He explained each part of the ratemaking formula, starting with expected losses. Mr. Evans stated there are three components used to calculate expected losses. He described the first component as losses that are consistent throughout the state (for example, number of fires, dog bites, burglaries). He explained that historical record is a fair indication of these losses. Mr. Evans mentioned that unusual, but expected, weather events like hailstorms, thunderstorms and tornadoes are also factored in the calculation of expected losses. He said the average occurrence of these unusual, but expected, events is used when calculating this aspect of expected losses. Mr. Evans explained the final aspect of expected losses as rare, potentially catastrophic events that occur with some degree of regularity (for example, hurricanes). He stated that modeling is used to calculate these events and the modeling process will be discussed in further detail later in the Rate Bureau's presentation.

Senator Brown asked how much of the expected losses calculation is based on claim history.

Mr. Evans said all three components of expected losses are rooted in claim history. He explained that historical data, modeling and trending are used to determine expected losses.

Senator Hise asked how the Rate Bureau determines when a model has expired.

Mr. Evans said with residential property insurance, the Rate Bureau files a new rate level every two years and with homeowners insurance, the Bureau has been preoccupied with litigation and has not been able to stay consistent with a new rate filing every two years. He stated that a new rate level filing for homeowners insurance has not been made in the past six years due to litigation; a time period the Rate Bureau did not anticipate.

Senator Hise clarified his question and asked Mr. Evans if the rate is changed once it is approved.

Mr. Evans explained that the approved rate continues until another rate is approved.

Senator Hise asked Mr. Evans to define the factors used to determine rate levels.

Mr. Evans explained when expected losses, expected expenses and reasonable profits are calculated all 3 together become a 'premium pool'. He said the premium is then determined based on factors such as the territory the property is in, value of the property, location of the property, age of the property and type of construction of the property. He explained there are more than 15 components to determine rate for an individual property.

Senator Hise requested a list of those 15 components used to determine rate for individual properties.

Mr. Evans stated he would provide a list of the components at a later date.

He then defined expected expenses as the expenses related to what the insurance company spends adjusting claims, paying taxes, paying commission to agents or for general operations. He also defined a reasonable profit as the profit a company would have to make in order to keep investors motivated to invest in that company. Mr. Evans concluded by reiterating that expected losses, expected expenses and reasonable profit are all used in the calculation of a premium. He said a premium is further individualized for a specific home (based on construction, location and value).

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Mr. Evans mentioned ratemaking standards as outlined in North Carolina General Statute 58-36-1 (see attachment 1).

Representative McElraft was recognized for a question. Representative McElraft asked Mr. Evans why modeling was based on Gulf Coast catastrophe history rather than on North Carolina catastrophe history.

Mr. Evans stated he did not think that modeling in North Carolina was based on the Gulf Coast. He also stated that the Rate Bureau would be discussing modeling in the next part of their presentation.

Mr. Evans introduced the next speaker for the Rate Bureau, Ms. Shantelle Thomas, a Senior Actuary for Allstate, Chair of the Rate Bureau's Property Insurance Committee, Board Member of the Beach Plan and Fellow of the Casualty Actuarial Society. He mentioned she graduated from Northwestern University and will explain hurricane modeling.

Ms. Shantelle Thomas thanked the committee for the opportunity to speak and started her presentation with a brief history of catastrophe models (see attachment 1). She mentioned AIR Worldwide was one of the first catastrophe models used and is still a leading model.

She then provided an example (naming a number of hurricanes since 1998) of why the Rate Bureau uses catastrophe models (see attachment 1).

She defined a catastrophe model and explained that the models are updated based on scientific knowledge (see attachment 1). Ms. Thomas provided an example of events that occurred in Mississippi to explain the function of a catastrophe model (see attachment 1). She referenced two models of Mississippi; one depicting storms over a 100,000 modeled year period of time and one depicting storms for a 100 year period. Ms. Thomas further explained that the 100,000 modeled year image represents simulated events from a model based on known characteristics of the actual storms in the 100 year image. She stated the 100 year image is based on actual historical data (actual catastrophes).

Ms. Thomas explained the limitations of historical data (see attachment 1) and connected these limitations to the need for catastrophe modeling. She said that the frequency of storms over time has not been constant so the historical record does not reflect the full range of possible hurricane events. Ms. Thomas continued by explaining historical record is not the only limitation for predicting catastrophic events. She said significant changes in the characteristics of a home, shifts in population and changes in policy coverage may all be limitations making historical loss data an unreasonable estimate for future losses (see attachment 1).

Ms. Thomas mentioned the model estimates damage based on engineering and changes in building codes over time.

She concluded by stating that catastrophe models are the best predictor of hurricane risk and are the best way to determine rates.

Senator Brown recognized Representative Iler for a question. Representative Iler asked how the Rate Bureau's models take into account damage inland, not just damage on the coast.

Ms. Thomas said the model considers where the storm makes landfall and the storm's track inland through the state. She said the model also considers wind speed when the storm makes landfall as well as wind speed as it travels inland in the state. She stated there is generally a decrease in cost associated with hurricane loss the more one travels inland in the state.

Representative Iler asked if a storm's landfall in South Carolina would affect the rates in Charlotte, North Carolina.

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Ms. Thomas said when rates are set in North Carolina there would be no assessment of damage in South Carolina homes. She said, if a storm makes landfall in South Carolina and then travels up through North Carolina, losses would be assessed in North Carolina.

Representative Iler asked if the Rate Bureau is using any historical data (he used the example of Hurricane Hugo) for these models.

Ms. Thomas said the models are built around the history of hurricanes in North Carolina and in surrounding states. She said historical hurricane record allows the Rate Bureau to base ratemaking on aspects such as changes in wind speed as the hurricane moves inland.

Representative McElraft then asked a series of questions. She asked if modeling takes into account North Carolina's stringent 'set back laws', building codes and tie downs.

Representative McElraft also asked if the Rate Bureau provide a model for North Carolina. She stated she finds it difficult to explain to constituents that North Carolina's insurance rates have been based on Mississippi modeling.

Ms. Thomas explained she is aware it is commonly misconstrued that losses from other states are taken into account when rates are made in North Carolina. She said this is definitely not true. She explained the hurricane model from AIR shows the specifics from the building codes in North Carolina and the changes in code over time. Ms. Thomas apologized for including the Mississippi model in the presentation and explained this data was readily available at the time the presentation was prepared. She said she thought the Rate Bureau may have an opportunity to provide more specific data for North Carolina at a later date.

Representative McElraft thanked Ms. Thomas for this information.

Senator Hise was recognized for a question. Senator Hise asked what the model is based on- loss of policy over its lifetime or expected loss over a year.

Ms. Thomas responded that the Rate Bureau looks at the statewide average annual amount of loss.

Senator Hise asked if this calculation is based on 100,000 policy years. He said he thought the Rate Bureau would have to collect those premiums over the same time period to have a guaranteed 'balance out' for that year.

Ms. Thomas said there is a potential the losses could exceed the premiums insurance companies collected that year. She explained this is why companies purchase reinsurance.

Senator Brown asked how many companies in the state have purchased reinsurance.

Ms. Thomas stated she didn't know the answer. She said she guessed that most companies have purchased reinsurance.

Senator White asked about the geographic concentration model and how this model is calculated. He provided an example of a county on the coast.

Ms. Thomas said it is based on a measure of shifts in population, not geographic concentration. She stated it is calculated based on where the current policyholders are located.

Senator White clarified that Ms. Thomas said the geographic concentration model is based on the number of policies sold in a geographic location not solely based on geographic location.

Ms. Thomas said this model is only based on where homes are located in a certain geographic location.

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Ms. Thomas concluded her presentation.

Mr. Ray Evans continued the Rate Bureau's presentation by asking Representative McElraft if he had answered her question from earlier in the presentation.

Representative McElraft requested (again) that the committee be presented information regarding modeling in the ratemaking process for the 20 coastal counties.

Senator Brown mentioned he would like to see the ratemaking models for the whole state.

Representative McElraft said she would like to see the models for the whole state in comparison to the 20 coastal counties. She also asked for statistics regarding types of damage experienced throughout the state (coastal versus inland damage and flood versus wind damage).

Representative McElraft asked the Rate Bureau for claim figures.

Mr. Evans said the Rate Bureau will compose reports for the next meeting in order to answer the committee's questions.

Mr. Evans then discussed House Bill 1305 and addressed questions the committee had from the last meeting (see attachment 1).

Mr. Evans explained a graph of coastal exposure. He pointed out that North Carolina has a significant amount of coastal exposure.

He said he believed this was a result of the current rate models not being adequate for the exposures which caused policies to migrate to the residual market.

Senator Brown asked how this data has changed since House Bill 1305 passed and placed a cap on exposure.

Mr. Evans said the Rate Bureau's data comes from the Beach Plan and deferred the question to the Beach Plan presenter. He said the Rate Bureau would find the information at a later date if a representative of the Beach Plan cannot answer the question.

He then discussed property territories (see attachment 1). He explained the Rate Bureau and Department of Insurance has been reviewing the property territories in the state for the past few years. He then discussed the requirements for determining a territory (for example, territories need to have similar exposures and losses).

Mr. Evans provided territory definitions and statutory definitions of terms from the North Carolina Insurance Underwriting Association/ Beach Plan (see attachment 1).

Representative Iler asked Mr. Evans about reviewing the territory that includes Brunswick County.

Mr. Evans stated this territory is being reviewed because the Rate Bureau is trying to determine how the territory may be separated into smaller territories with more homogenous characteristics. He said the Bureau is researching using Highway 17 as a territory boundary.

Representative Iler asked how dividing this territory will affect rates.

Mr. Evans stated if the Rate Bureau decided to create a coastal territory with Highway 17 acting as a geographical boundary, the people west of Highway 17 may have a lower rate but the people east of Highway 17 would have a higher rate.

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Representative Iler asked if building codes for homes would be a rate-determining factor.

Mr. Evans stated that building codes influence rates/ modeling but the Rate Bureau can't assume that the homes east of Highway 17 are built one way and homes west of Highway 17 are built another way.

Representative McElraft asked if the Rate Bureau could give a mitigation credit for homes built at a higher standard than building code.

Mr. Evans agreed with Representative McElraft stating it is reasonable to give a mitigation credit (and lower premium) for homes that are built at a higher standard than building code.

He concluded the Rate Bureau's presentation by explaining the hurricane mitigation credit program (a result of House Bill 1305) (see attachment 1).

Mr. Ray Evans mentioned that Mr. Bill Trott of Young, Moore and Henderson and counsel to the Rate Bureau was available for questions.

Senator Brown asked for final questions for Mr. Ray Evans and the Rate Bureau. He recognized Representative Iler for a question.

Representative Iler asked if it is too early for his constituents to ask insurance companies for mitigation credits.

Mr. Evans said the mitigation program is fully operational.

Senator Hise asked about the concept of a 'zero sum formula' in regards to mitigation credits.

Mr. Evans stated that mitigation credits are not based on a 'zero sum formula'. He said building a home at a higher standard than building code reduces exposure which in turn reduces premium and future losses.

Mr. Evans said an expert on building codes would present later in the meeting to answer questions regarding building codes.

Senator White asked who determines the value of the mitigation credits.

Mr. Evans stated the Rate Bureau (through the Institute for Business and Home Safety, IBHS) determines the value of the mitigation credits based on extensive research.

Senator White reiterated his question by providing an example. He mentioned that he owns a construction company which uses standards higher than building code. He asked who determines the value applied as a mitigation credit based on the precautions an individual takes to prevent damage.

Mr. Evans responded by stating there is a group of licensed inspectors that evaluate and determine if the credit is appropriate for the building.

Representative McElraft mentioned her constituents have complained that they're paying around \$500 for an inspector to approve the construction of their home for mitigation credits when they're only saving five percent on their policy. She asked if her constituents could provide pictures of the construction of their homes to avoid paying \$500 for an inspectors visit.

Mr. Evans said that is an individual insurance carrier issue/ policy.

Representative McElraft stated she was specifically referring to the Beach Plan.

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Mr. Evans deferred the question to a representative of the Beach Plan.

Representative McElraft asked if there is a mitigation credit for individuals who have not filed claims over a certain period of time.

Mr. Evans stated the insurance company decides whether to provide this credit or not. He said the mitigation credit is designed to reduce losses over a large population over a long period of time.

Representative McElraft clarified and stated she was referring to the \$500 inspection fee.

Mr. Evans said that is an individual insurance company policy and if any of the questions mentioned in their presentation are not addressed later in the meeting the Rate Bureau will be happy to find the answers for future meetings.

Senator Brown thanked Mr. Evans and the Rate Bureau for their presentation.

North Carolina Department of Insurance

Senator Brown introduced Ms. Rose Vaughn-Williams to present on behalf of the Department of Insurance.

Ms. Rose Vaughn-Williams discussed the elements of premium determination (see attachment 2 a.) and factors in rate and premium setting (see attachment 2 b.).

She then presented a chart (see attachment 2 a.) showing the decomposition of rates for homeowners insurance from a 2008 Rate Bureau homeowners filing.

Ms. Vaughn-Williams mentioned the largest percent of the filing is a non-modeled base class loss cost (actual claims, expenses and the cost to adjust those claims). She also pointed out modeled loss cost (for hurricane modeled losses and Rate Bureau filings with the Department of Insurance), fixed expenses (for example, building mortgage, rent, salaries) and deviation (for example, discounts).

Representative Iler asked if reinsurance was offered by insurance companies to reduce their risk and wanted to know why consumers are paying for additional profit for reduced risk for insurance companies.

Ms. Vaughn-Williams said the chart represents the filing that was made but she did not know if the Department of Insurance agrees with the filing.

Representative Iler asked if the 2008 filing had been approved.

Ms. Vaughn-Williams explained the 2008 filing was a settlement and 13 percent of what the companies asked for was awarded to the insurance companies.

Representative Iler asked if the rates that are in effect now include reinsurance and, if so, why would these rates be legitimate.

Ms. Vaughn-Williams stated she didn't know how to answer the question further except she knew the Department doesn't agree with the filing for that portion of the pie chart. She reiterated this rate filing was a settlement.

Senator Hise asked if a company has to have assets available to cover risk if the company chooses not to reinsure its potential losses.

Ms. Vaughn-Williams said the individual insurance companies should be able to answer Senator Hise's question.

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Ms. Vaughn-Williams then provided a chart of the Rate Bureau's Homeowners Territories prior to the Rate Bureau's redefinition of the territories in 2008.

Ms. Vaughn-Williams discussed the modeling process (see attachment 2 b.).

She then addressed a question from the previous meeting regarding how many companies actually write homeowners insurance in the state. She presented a chart entitled "North Carolina Residential Property Written Premiums, 2010" (see attachment 2 a.). Ms. Vaughn-Williams explained there are 63 insurance groups and 125 insurance companies actually writing insurance in the state. She defined the term "beach" as an area close to sand (for example, the outer banks) and the term "coastal" as an area inland. She said there are no companies writing more than \$10 million worth of premiums in the beach area and discussed the data for the policies in the beach and coastal counties (see attachment 2 a.). Ms. Vaughn-Williams mentioned there are more companies writing policies in inland coastal counties.

Questions for the Department of Insurance

Representative McElraft asked how many companies are represented in the Beach Plan.

Ms. Vaughn-Williams referred this question to the representatives of the Beach Plan.

Mr. Alvin Ashworth, representing the Beach Plan, responded to Representative McElraft's question. He explained there are 176 companies participating in the Beach Plan across the state.

Industry Representatives

Nationwide Mutual Insurance Company

Senator Brown introduced Ms. Susan Valauri, Senior Director of Government Relations for Nationwide Mutual Insurance Company.

Ms. Valauri began her presentation by giving an overview of the history of Nationwide and providing statistics of the number of policies (over 700,000) and associates (1,200) the company has throughout the state (see attachment 3).

She then discussed homeowners insurance and the market dynamics for homeowners insurance (see attachment 3).

Ms. Valauri showed a presentation of the catastrophes North Carolina has faced in the past. She emphasized why companies do not invest in North Carolina. This presentation was not provided to the committee prior to or after the meeting.

The presentation included pictures from seven catastrophic events in 2011 in North Carolina (to date).

Senator Brown asked Ms. Valauri to mention the regions of the state where these catastrophes occurred.

She said the presentation depicts 7 storms that occurred throughout the state. She emphasized, of the 30 counties the committee members collectively represent, none of the counties the committee members represent are considered 'profitable' counties. She mentioned 18 of the counties have loss ratios greater than 100 percent and explained for every dollar in premium paid in, Nationwide paid out more than \$1 in premiums.

She defined a catastrophic event as an event in which a significant number of industry claims (thousands) are reported, a significant number of carriers are impacted and at least \$25 million in insurable damages are reported.

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Ms. Valauri pointed out the nomenclature ‘cat 53’ means there were 53 catastrophes on a national scope in a year.

She mentioned ‘cat 59’ was Hurricane Irene and most of the other storms were wind and hailstorms. She also mentioned ‘cat 42’ and ‘cat 43’ as events that affected the central part of the state and ‘cat 44’ as a storm that affected the northeastern and southeastern regions of the state.

Ms. Valauri emphasized the presentation showed catastrophic events and does not include what Nationwide declares “baseline, regular” weather events.

She then explained why companies do not invest in North Carolina (see attachment 3).

Ms. Valauri discussed the long period of little/no storm activity, the business climate today and non-negotiable items for Nationwide (see attachment 3).

Ms. Valauri discussed coastal exposure, inland exposure and pricing as aspects for a desirable business climate in the state (see attachment 3).

She also thanked the General Assembly for passing House Bill 1305, allowing the insurance companies to know the risk from losses in the Beach Plan.

Questions for Nationwide Mutual Insurance Company

Representative Iler asked for a county comparison of premiums versus claims filed throughout the state.

Ms. Valauri said the Rate Bureau should be able to provide that information. She said it would be inappropriate for her as a representative of Nationwide to provide that information.

Representative McElraft asked, of the 44,000 claims, how many were filed on the coast from Hurricane Irene and how many of those claims were wind claims.

Ms. Valauri stated they were all wind claims, mostly in the southeast. She clarified that the claims she referred to earlier were claims filed as a result of Hurricane Irene.

Senator Brown asked if most of the 13,000 claims were from the southeast.

Ms. Valauri confirmed that most of the 13,000 claims were in the southeast.

Senator Brown said that data was interesting because most of the storm damage was not in the southeast.

Representative McElraft requested that Nationwide provide the committee with data showing where the 13,000 claims were filed.

Ms. Valauri said she would provide that information at a later date.

Ms. Valauri stated that Senator Brown’s county (Onslow County) is not having a ‘good loss ratio’ this year.

Senator Hise asked what Ms. Valauri meant in regards to her statement that “rates are significantly low”. He asked if she based that statement on the idea that the model currently used in the state did not project losses or the fact that the state has had a lot of severe weather in the past year.

Ms. Valauri said it is a combination of both. She said rates may be lagging the actual experiences of the state.

There were no further questions for Ms. Valauri.

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North Carolina Farm Bureau Mutual Insurance Company

Senator Brown introduced Mr. Steve Carroll, Vice President and General Manager of Farm Bureau Mutual Insurance Company.

Mr. Carroll started with a brief introduction of the North Carolina Farm Bureau (see attachment 4).

Mr. Carroll discussed Farm Bureau's role in Property Insurance Rate Making (see attachment 4).

Mr. Carroll mentioned that North Carolina has experienced three of the six worst storms in the state's history solely in 2011. He emphasized that coastal areas are the Farm Bureau's major concern but their concern has moved inland as tornadoes and hailstorms have affected areas west of the coast.

He said North Carolina has been lucky that storms affecting the majority of the southeast did not affect our state in the last several years.

Mr. Carroll stated that the Farm Bureau will have to cancel 30,000 property policies statewide and eventually 20 percent (100,000 policies) of their total property policies because the premium amount does not support the Farm Bureau's cost of doing business.

He said 40 percent of premiums will go to reinsurance, 25 percent will go to expenses and 35 cents out of every dollar to pay everyday losses (non-catastrophe losses). Mr. Carroll stated that these figures will not allow the Farm Bureau to do competitive business in North Carolina.

He stated Farm Bureau's automobile insurance business subsidizes their property insurance business.

He mentioned the Beach Plan has \$800 million in reserves and will lose around \$150 million of surplus as a result of Hurricane Irene. He stated this will increase the cost of reinsurance.

He then discussed the committee's directives (see attachment 4).

Questions for North Carolina Farm Bureau Mutual Insurance Company

Representative McElraft asked how many reinsurance companies are in business with Farm Bureau.

Mr. Carroll said the size of their program is large; every major reinsurance company in the world does business with Farm Bureau. He said their major partners are American Agriculture Reinsurance and Guy Carpenter. He stated they work with fifty carriers throughout the world.

He mentioned the Beach Plan and Farm Bureau are the top purchasers of reinsurance in the state.

Representative Wray asked Mr. Carroll if the Farm Bureau was really planning on eliminating 30,000 property insurance policyholders.

Mr. Carroll said the company started eliminating policies November 1, 2011. He stated unless something significantly changes in the next 3 to 4 years they will eliminate around 100,000 policies.

Representative Wray asked Mr. Carroll to explain the notification process for dropping a consumer's policy.

Mr. Carroll said the policy cancellation notice must be sent out 30 days prior to the policy renewal date. He mentioned the Farm Bureau gives 60 day's notice to its consumers and the insurance agents are aware of the elimination of the policy 90 days in advance.

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Mr. Carroll emphasized the decision to eliminate policies is the hardest decision Farm Bureau has to make but the company would not be able to continue with business if the elimination process did not take place.

Senator Brown asked what premium amount it would take for Farm Bureau or Nationwide to write policies on the coast and stay in business without eliminating policies.

Mr. Carroll said it would take substantial rate increases but he couldn't answer Senator Brown's question at this time.

Ms. Susan Valauri of Nationwide also stated she did not have the answer to Senator Brown's question at this time.

Mr. Carroll mentioned the hailstorms and tornadoes that have recently affected the state as proof of the changing weather patterns throughout the southeast. He said if insurance companies in North Carolina plan to write property insurance policies in the future, our state will have to increase rates.

Representative Iler mentioned companies dropping property policies because consumers had two different carriers for automobile and property insurance. He asked if this will be a trend.

Mr. Carroll said this is becoming a trend nationally and in North Carolina.

Representative Jordan referred to an article from the *News & Observer* that discusses linking automobile and property insurance policies. He asked Mr. Carroll if he knew the companies noted for linking these policies.

Mr. Carroll stated he thought those companies were State Farm and Nationwide.

Ms. Susan Valauri of Nationwide emphasized that Nationwide does not link policies.

Ms. Erin Engle, a representative of State Farm, was recognized from the audience and stated that State Farm does not require its customers to link automobile and property insurance policies.

Mr. Carroll stated that Nationwide and State Farm have requirements on property insurance policies that Farm Bureau does not have.

Representative Jordan asked if there was a rate percentage increase in 2009 that would have helped the insurance business climate for insurance companies in the state.

Mr. Carroll said the full 19.5 percent increase that the Rate Bureau requested would have helped the Farm Bureau.

Representative McElraft mentioned she has a number of constituents who are unable to get homeowners/fire policies because they do not have wind policies. She asked if these constituents would be allowed to get fire policies if they are self-insuring for wind damage and have no wind policy from an insurance company.

Mr. Carroll explained if a customer does not purchase a wind policy through the Beach Plan, the Farm Bureau will not allow that customer to purchase a regular homeowners policy for other perils. He said this company policy is in place to protect agents and prevent errors.

Representative McElraft asked if a consumer could sign a waiver that exempts them from a wind policy. She mentioned this could be something the General Assembly could do through statute. Representative McElraft said if a consumer doesn't have a mortgage they should be able to self-insure for wind damage.

He stated if Farm Bureau was legislatively required to allow for a waiver they would, of course, follow those guidelines.

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Property Casualty Insurers Association of America

Senator Brown introduced Mr. Don Griffin, Vice President- Personal Lines, Property Casualty Insurance Association of America.

Mr. Griffin provided a brief introduction and stated he will be discussing the significance of House Bill 1305, the impact of the Rate Bureau and the importance of territorial rating and risk-based pricing (see attachment 5).

Mr. Griffin started by giving a history of rate suppression (see attachment 5).

Senator Brown said some areas of the state were given rate increases and some areas were given rate decreases in the last rate cycle. Senator Brown asked why some areas had their rates reduced.

Mr. Griffin said the companies writing insurance in certain areas of the state did not have losses or a history of losses like other areas.

He used the Rate Bureau's example of the industry basing calculations on a 'zero sum formula'; he stated that if the industry is paying out \$100 in losses they need to collect at least \$100 in premiums. He said, for instance, if every consumer is charged \$100, some consumers are paying \$75 and some are paying \$125.

Senator Brown mentioned Mecklenburg County had a rate decrease in the latest rate cycle. He said Hurricane Hugo affected Mecklenburg County and the hailstorms this year affected Mecklenburg County, yet, their rates decreased. Senator Brown said he did not understand the rate decrease in Mecklenburg County.

Mr. Griffin said he agreed with Senator Brown and that he thought actuaries of the Rate Bureau may be able to help him understand the rate decrease in Mecklenburg County.

Mr. Griffin then continued by discussing the significance of House Bill 1305 (see attachment 5).

He said North Carolina has historically enjoyed a fairly competitive marketplace and rates in the state are lower than in other states (by 15-20 percent). He also mentioned, prior to the passage of House Bill 1305, the Beach Plan was growing at a rate of \$1 billion per month. He stated House Bill 1305 slowed the growth of the Beach Plan and stabilized rates.

Mr. Griffin discussed the impact of the North Carolina Rate Bureau on property insurance rates highlighting the fact that North Carolina is the last state that uses this ratemaking process (see attachment 5).

He also mentioned he is worried that North Carolina will end up like Florida if rate suppression continues.

He then explained the importance of territorial rating and risk-based pricing and concluded PCI's presentation by highlighting the positive impacts of House Bill 1305. He mentioned the need for North Carolina to move toward a market-driven insurance industry (see attachment 5).

Questions for Property Casualty Insurers Association of America

Representative Iler asked why his insurance on the coast increases up to \$500 annually.

Mr. Griffin said companies have the ability to increase premiums.

Representative Iler also referred to North Carolina General Statute 58-36-10 which states that rates "shall not be excessive, inadequate or unfairly discriminatory". He said he was concerned that rates on the coast are unfairly discriminatory.

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Mr. Griffin said the statute Representative Iler referred to is a statute in virtually every state. He said the ‘unfairly discriminatory’ part is difficult because companies cannot rate one specific homeowner’s policy. Mr. Griffin explained, in order to make rates unfairly discriminatory, homogeneous groups are created and similar rates are applied in those groups.

Representative Iler stated he is more concerned with unfair discrimination in rates in certain territories.

Senator Hise asked Mr. Griffin how the state can evaluate actuarially sound rates for every policy.

Mr. Griffin said companies cannot currently deviate from rates established by the Rate Bureau; he said a more open market would allow companies to be more competitive. He emphasized before this can happen an adequate rate has to be established.

Senator Brown closed the discussion.

Agent’s Commissions and the Financial Status of the Beach Plan

North Carolina Insurance Underwriting Association (NCIUA) (the Beach Plan)

Senator Brown introduced the next presenter, Mr. Lee Dunn, Assistant General Manager of the Beach and FAIR Plans.

Mr. Dunn addressed questions raised at the last meeting. He addressed the number of policies exceeding \$750,000 in value. He said after House Bill 1305 was passed, the Beach Plan had 190,000 policies and only 3,000 of those policies exceeded \$750,000 in value. He said the FAIR Plan had 70,000 policies and only 25 of those policies exceeded \$750,000 in value.

Mr. Dunn mentioned that, at the time of House Bill 1305, the Beach Plan had \$72 billion in aggregate liability that covered both the coastal and beach areas. He said, after House Bill 1305 passed, the Beach Plan has grown 3 percent.

He also addressed a question posed in the last meeting regarding guidelines for mitigation credits.

He said the insured can provide photos for a credit for their roofing system and proof of installation for storm shutters but a building inspector must certify that the mitigation credit for property meets ‘IBHS’(Institute for Business and Home Safety) guidelines.

Mr. Dunn also stated that the NCIUA/ NCJUA can provide the number of insurers writing coastal, Beach and FAIR Plan insurance at a later meeting.

He then emphasized that House Bill 1305 capped insurers’ losses under the Beach Plan at \$1 billion annually and stated that the NCIUA/ NCJUA is at its maximum capacity in reinsurance.

Mr. Dunn referred to Representative McElraft’s question regarding the number of reinsurers associated with the NCIUA/ NCJUA. He said there are 60 reinsurers associated with the NCIUA/ NCJUA.

He said, from a financial standpoint, the NCIUA/ NCJUA currently has protection for approximately \$4 billion of damage from a storm.

He also reiterated that the Beach Plan does not make rates; the Beach Plan applies the rates determined by the Rate Bureau.

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Senator Brown asked for questions from the committee.

Representative McElraft asked if she was correct in stating that the Beach Plan spent \$150 million for Hurricane Irene.

Mr. Dunn said the damage projection for Hurricane Irene is between \$120 million and \$130 million.

Representative McElraft then asked how much is spent by the Beach Plan for reinsurance.

Mr. Dunn stated he will answer that question in a chart provided in the handout.

Mr. Dunn then explained agent's commissions and the 2011 Fiscal Year financial status for the NCIUA/ NCJUA (see attachment 6).

He pointed out the reinsurance expense for the 2011 Fiscal Year is approximately \$221 million (see chart in attachment 6).

Representative McElraft asked if the reinsurance expense amount changed annually.

Mr. Dunn said the reinsurance expense changes every year based on liability and the reinsurance market.

Senator Brown asked if the reinsurance companies will pay anything on North Carolina's losses.

Mr. Dunn said the companies will not pay anything on the state's losses this year.

Representative McElraft asked if reinsurance companies had to pay North Carolina anything out of the \$221 million spent in reinsurance this year.

Mr. Dunn stated reinsurance companies did not have to pay the state any amount out of the \$221 million expense; he said if the NCIUA/ NCJUA were to get more money in premiums, their retained earnings would increase.

Senator Brown asked Mr. Dunn to continue his presentation due to time constraints.

Mr. Dunn then discussed the commission structure for the NCIUA/ NCJUA and explained the certification process required for agents working for the NCIUA/ NCJUA (see attachment 6).

He concluded his presentation by providing additional information about the commission structure (see attachment 6).

Questions for the NCIUA/ NCJUA

Senator Brown asked about the 12.2 percent commission for a wind policy.

Mr. Dunn said (in the Beach Plan) the commission for an agent for dwelling insurance is 13 percent.

Representative McElraft asked why agents are necessary when the payment for insurance goes directly to the NCIUA.

Mr. Dunn explained that there are no licensed agents at the NCIUA/ NCJUA; he said an insurance agent is a licensed professional that can explain individual need to the consumer. Mr. Dunn said the NCIUA/ NCJUA cannot give professional advice.

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Senator Hise did not understand why two thirds of insurance money is used to insure for a catastrophe but in the private market 11 percent is too much for a catastrophe.

Mr. Dunn said most insurance companies can go outside of the state to help offset catastrophe costs, whereas the NCIUA/ NCJUA cannot.

Senator Brown asked what percentage of the state's insurance business is in the Beach Plan.

Mr. Dunn stated the NCIUA/ NCJUA has 73 percent in the beach area, 37 percent in the coastal counties and 13 percent statewide.

Representative McElraft asked if a consumer could be given a discount if they go directly to the NCIUA/ NCJUA instead of using an agent.

Mr. Dunn said he could not answer Representative McElraft's question.

Senator Brown thanked Mr. Dunn for his presentation and asked for approval of the committee's minutes from the November 2, 2011 meeting. Representative McElraft approved Senator Brown's motion and the committee unanimously approved the minutes from the previous meeting.

Wilmington Regional Association of REALTORS

Senator Brown introduced Ms. Kathleen Riely as the Governmental Affairs Director for the Wilmington Association of REALTORS.

Ms. Riely introduced the 'key question' for her presentation (see attachment 7). She asked the committee if the system currently used to set property insurance rates is the best system for insurance companies and for all citizens in the state.

She asked the committee to look at how other states operate in regards to ratemaking.

She then briefly discussed six issues associated with the current ratemaking process (see attachment 7).

She first discussed replacing the Rate Bureau with a market-based rate setting system or with a regulatory commission similar to the current Utilities Commission in North Carolina (see attachment 7). She emphasized Florida's Hurricane Catastrophe Fund and provided links to information about their system.

Ms. Riely continued by mentioning legislative oversight of the Rate Bureau and the idea of eliminating the Rate Bureau in North Carolina (see attachment 7).

She then discussed the adequacy of the Insurance Commissioner's duties in regards to protecting policyholders against excessive, inadequate and unfairly discriminatory rates. Ms. Riely directed the committee to look at the Florida Sunshine Law which allows for public hearings in the event of a rate increase over 15 percent (see attachment 7). She said the main problems she sees in North Carolina involve transparency, responsibility and accountability (see attachment 7).

Ms. Riely discussed the modeling process used to determine rate increases or decreases. She said modeling alone is not sufficient (see attachment 7). She discussed two models used in other states: a 'RMS model' and an 'AIR model'. She explained that a RMS model looks at inland rates and normally results in higher inland rates. She explained an AIR model looks at coastal rates and results in higher coastal rates. Ms. Riely mentioned she found it interesting that North Carolina only uses the AIR model when determining rates and she does not understand why the state does not have a commission that researches modeling.

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Ms. Riely discussed charts presenting data from the 2008 rate filing (see attachment 7 and link to chart).

She pointed out that the coastal counties faced rate increases and counties surrounding Mecklenburg County and Charlotte received rate decreases (see attachment 7 and link to chart). Ms. Riely said there was a very obvious geographic discrepancy in the rate filing. She said she further researched the discrepancy and found other data showing that rate increases in coastal areas and decreases in other areas of the state have become a trend. She presented data from a 1993 rate filing in which rates increased well over 100 percent in Brunswick, New Hanover and Carteret counties and rates decreased over 2 percent in Gaston, Mecklenburg and Union counties.

She then mentioned data of claims paid in 1986; she said the cumulative coastal county wind losses compared to state losses was 26 percent. Ms. Riely reiterated that she didn't understand why the eastern part (coast) of the state was paying higher rates while more losses are normally incurred inland (not just on the east coast) from Gulf Coast storms.

Ms. Riely stated she would like North Carolina to use a combination of models, data and science to develop a streamline, transparent and accountable system to determine rates.

Questions for the Wilmington Regional Association of REALTORS

Representative Iler asked that the charts in Ms. Riely's presentation be made available to the committee.

North Carolina Home Builder's Association

Senator Brown introduced Mr. Robert Privott, Director of Codes and Construction for the North Carolina Home Builder's Association.

Mr. Privott mentioned he will yield a portion of the end of his presentation to Mr. Tyler Newman, Governmental Affairs Director with Business Alliance for a Sound Economy.

Mr. Privott provided a brief background of the state's building code and the Council that sets North Carolina's building code (see attachment 8).

He explained that the Council focuses on ensuring the adequacy of the North Carolina State Building Code with regard to commercial and residential construction throughout the state. He emphasized that determining sufficient levels of protection requires balancing what is technically possible and economically feasible. He also stated that the code has been revised several times in response to new findings (see attachment 8). Mr. Privott pointed out that the Council has adopted significant changes to the North Carolina Residential Building Code in a recent code making cycle.

Mr. Privott then provided an explanation of mitigation credits and a list of recommendations from the North Carolina Home Builder's Association (see attachment 8).

Senator Brown asked Mr. Privott to provide the average cost of codes for a home on the coast compared to inland cost.

Mr. Privott said the cost varies (from \$20,000 to \$25,000 per structure).

Senator Brown asked how long the coastal code requirements have been in place.

Mr. Privott said coastal requirements have been in place for 15 to 20 years.

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Senator Brown clarified that the coast has had a different set of building codes for (at least) 15 years costing \$20,000 more than inland structures per unit.

Mr. Privott said Senator Brown was correct.

Mr. Tyler Newman then discussed homeowners insurance from a coastal perspective.

He used his own home, a 1992 brick frame house located 5 miles inland and west of Highway 17, as an example of how rates affect modest homes on the coast (not built directly on the water) (see attachment 9).

Mr. Newman provided a comparison of a Wilmington homeowners wind/hail policy and a Raleigh homeowners wind/hail policy. This comparison showed that coastal residents are paying more for homeowners' policies and wind/hail policies than inland residents (see attachment 9).

He then provided the committee with a list of recommendations to improve the issues with homeowners insurance throughout the state. He briefly mentioned that House Bill 1305 ensured the financial stability of the Beach Plan. He stated North Carolina needs to develop a way to provide more access to public record regarding past claims, storms and rates and also enable more companies to write insurance in the state (see attachment 9).

Senator Brown adjourned the meeting at 4:07 PM.

Respectfully submitted this 5th day of December, 2011

Elise Quick, Committee Assistant

Senator Harry Brown, Committee Chair